

## Message Text

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ACTION AID-59

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TO SECSTATE WASHDC PRIORITY 3943

INFO AMCONSUL BOMBAY

AMCONSUL MADRAS

AMCONSUL CALCUTTA

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PASS AID AND TREASURY

EO 11652: NA

TAGS: ECON, EAID, IBRD, IN

SUBJ: COMMENTS ON WORLD BANK REPORT ON INDIAN ECONOMY

REF: A. STATE 109767, B. NEW DELHI 3149,

C. NEW DELHI 7923

SUMMARY: WORLD BANK REPORT IS A COMPREHENSIVE REVIEW OF STRUCTURAL PROBLEMS FACING THE ECONOMY. THERE IS AN IMPORTANT NEW SECTION ON POPULATION AND POVERTY WHICH WILL BE OF CONTINUOUS RELEVANCE TO LONG-TERM AID CONSIDERATIONS. WHILE THE BANK RECOMMENDS THAT GREATER PRIORITY BE GIVEN TO AGRICULTURE, EMPLOYMENT GENERATION, AND MORE EFFICIENT USE OF CAPITAL, WHETHER THE NEW GOVERNMENT CAN EFFECTIVELY IMPLEMENT THESE WORTHY GOALS IS BY NO MEANS SURE. WE BELIEVE THE BANK'S BALANCE OF PAYMENTS FIGURES ARE TOO PESSIMISTIC, AND WE ARE ESTIMATING LOWER TRADE DEFICITS THAN THE BANK IN IFY 1976/77 AND 1977/78. THE BANK CALLS FOR THE MAINTENANCE OF PRESENT

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LEVELS OF EXTERNAL ASSISTANCE (IN REAL TERMS, WE DO NOT CONTEST THAT RECOMMENDATION BUT WE BELIEVE SOME HARD QUESTIONS SHOULD BE ASKED AT THE JULY CONSORTIUM MEETING REGARDING THE GOVERNMENT'S PRESENT USE OF FOREIGN EXCHANGE RESERVES AND THE WAYS IN WHICH THE NEW GOVERNMENT INTENDS TO APPLY ADDED ASSISTANCE. END SUMMARY.

DOMESTIC ECONOMY.

1. THE LATEST WORLD BANK REPORT ON THE INDIAN ECONOMY WAS WRITTEN LAST JANUARY AND FEBRUARY AND IS, THEREFORE, SOMEWHAT OUT OF DATE REGARDING SHORT-TERM ECONOMIC TRENDS. IN GENERAL THE REPORT'S ACCOUNT OF INDIA'S DOMESTIC ECONOMIC PERFORMANCE IN 1976-77 IS SLIGHTLY MORE OPTIMISTIC THAN OUR ASSESSMENT. WE NOW THINK THAT LAST YEAR'S GROWTH WAS CLOSER TO ZERO THAN TWO PERCENT; THAT FOODGRAIN OUTPUT WAS IN THE RANGE OF 108-110 MILLION MT RATHER THAN 110-114 MILLION MT; AND THAT INDUSTRIAL PRODUCTION INCREASED BY CLOSE TO EIGHT PERCENT IN CONTRAST TO THE BANK'S PROJECTION OF TEN PERCENT.

2. IN GENERAL, THE BANK HAS MADE A GOOD ANALYSIS OF MAJOR PROBLEMS FACING THE INDIAN ECONOMY; POVERTY, SLOW GROWTH, UNEMPLOYMENT, INSUFFICIENT INVESTMENT, INFLATION, AND LACK OF EFFECTIVE DEMAND. HOW TO RECONCILE THESE LATTER TWO CONCERNS IS A MAJOR POLICY QUANDRY. THE REPORT HAS A VERY INTERESTING SECTION ON REASONS FOR THE SLOW DOWN IN ECONOMIC GROWTH SINCE THE MID 1960'S: VIRTUAL STAGNATION IN THE RATIO OF INVESTMENT TO GDP; INSUFFICIENT PUBLIC SECTOR INVESTMENT; AND A MARKED UPWARD TREND IN THE CAPITAL-OUTPUT RATIO AS THE EFFICIENCY OF CAPITAL USE HAS DECLINED APPARENTLY BECAUSE OF TOO MUCH EMPHASIS ON POWER-INTENSIVE HEAVY INDUSTRY, RAPID GROWTH IN PUBLIC ADMINISTRATION, AND REDUCED AGRICULTURAL EFFICIENCY AS LAND IS EXHAUSTED. HOWEVER, WE QUESTION THE BANK'S INVESTMENT AND SAVINGS RATES (AS PER-

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CENTAGES OF GDP); THEY ARE CONSIDERABLY HIGHER THAN THE FIGURES PUBLISHED BY THE CENTRAL STATISTICAL ORGANIZATION.

3. THE BANK RECOMMENDS HIGHER PRIORITY TO THE AGRICULTURAL SECTOR, BETTER CAPITAL UTILIZATION, AND EXPLOITATION OF INDIA'S COMPARATIVE ADVANTAGE OF ABUNDANT LABOR IN ORDER TO MOVE THE COUNTRY ONTO A HIGHER GROWTH PATH. LEADERS OF THE NEW GOVERNMENT DECLARE THEIR INTENTION OF GIVING HEIGHTENED ATTENTION TO RURAL DEVELOPMENT, TO UTILIZE ANY CAPITAL EXPENDITURES NEEDED FOR THIS PURPOSE, AND TO UNEMPLOYMENT PROBLEMS. HOW THEY WILL GO ABOUT THESE WORTHY GOALS, AND TO WHAT EFFECT, IT IS STILL TOO EARLY TO SAY. THE DIFFICULTIES ARE, OF COURSE, FORMIDABLE.

4. REGARDING THE CRUCIAL AGRICULTURAL SECTOR, THE REPORT NOTES THAT THE TRADITIONAL INPUT-LED GROWTH POLICY DOES NOT DEAL WITH MANY INSTITUTIONAL AND STRUCTURAL CONSTRAINTS. IT POINTS OUT THAT THE OUTLOOK IS BLEAK FOR MAJOR CHANGES IN LAND AND TENANCY REFORM, THE MOST IMPOR-

TANT FACTOR IN THE RURAL EMPLOYMENT EQUATION. WE BELIEVE  
THISPOINT IS VERY WELL TAKEN, BUT UNFORTUNATELY THERE IS  
LITTLE DISCUSSION OF IT. THE BANK'S FOCUS ON AGRICUL-  
TURE GENERALLY COINCIDES WITH AID'S EMPHASIS IN THIS  
AREA. THE BANK JUSTIFIABLY SINGLES OUT IRRIGATION AS THE  
MOST CRUCIAL INPUT FOR ANY SUCCESSFUL AGRICULTURAL STRATEGY,  
AND CORRECTLY THINKS THAT MORE RESOURCES SHOULD GO INTO  
IRRIGATION DEVELOPMENT. THE REPORT DISCUSSES IN A PER-  
CEPTIVE WAY THE NEED FOR BETTER COORDINATION OF POLICY  
FOR PRICING PROCUREMENT, DISTRIBUTION, STORAGE AND IMPORT  
OF FOODGRAINS. IT SAYS THAT THE GOI EXPECTS TOO MUCH  
FROM THE CONTROL OF FOOD PROCUREMENT PRICES AND THE PRO-  
CUREMENT SYSTEM. THE REPORT IS CRITICAL--RIGHTLY WE  
BELIEVE--OF IRRECONCILABLE GOVERNMENT OBJECTIVES: PRICE  
STABILIZATION AT LEVELS REMUNERATIVE TO FARMERS VS. PRO-  
CUREMENT FOR PUBLIC DISTRIBUTION AT LOW PRICES,  
NEITHER OF WHICH CAN BE RECONCILED WITH A FIXED PROCURE-  
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MENT PRICE.

5. THE BANK'S SECTION ON INDIAN INDUSTRY MAKES DEPRES-  
SING READDING. IT CLAIMS, AND WE THINK PERSUASIVELY,  
THAT THE SLOW DOWN IN INDUSTRIAL GROWTH HAS BEEN UE TO  
INSUFFICIENT AGRICULTURAL PROGRESS, GROSS INEFFIC-  
IENCIES IN INDUSTRIAL INVESTMENT ALLOCATIONS AND PRO-  
DUCTION, IMBALANCES BETWEEN THE STRUCTURE OF CREATED  
INDUSTRIAL CAPACITY AND DEMAND, STAGNAT CAPITAL FORMATION,  
AND THE VIRTUAL COMPLETION OF THE PROCESS OF IMPORT

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PASS AID AND TREASURY

SUBSTITUTION BY THE MID 1960S. CAPACITY UNDERUTILIZATION, WHICH HAS BEEN GENERALLY GETTING WORSE SINCE THEN, IS A SYMPTOM OF DEMAND WEAKNESS. ALTHOUGH THE REPORT POINTS OUT THAT ECONOMIC CONDITIONS HAVE BEEN FAVORABLE IN THE PAST TWO YEARS (GOOD HARVESTS, RISING EXPORTS AND REMITTANCES, ETC), THE BUOYANCY EXPECTED FROM THE INDUSTRIAL SECTOR DID NOT MATERIALIZE TO THE EXTENT DESIRED, MAINLY BECAUSE AGRICULTURAL INCOME APPARENTLY DID NOT RISE VERY MUCH. THE BANK ALSO NOTES, CORRECTLY, THAT ANY STIMULUS TO INDIAN INDUSTRY FROM EXPORTS IS LIKELY TO BE MODEST.

BALANCE OF PAYMENTS

6. AN AREA IN WHICH WE HAVE SOME DISAGREEMENT WITH THE WORLD BANK IS BALANCE OF PAYMENTS ESTIMATES FOR 1976/77 AND PROJECTIONS FOR 1977/78. THIS IS PARTLY DUE TO AVAILABILITY OF MORE RECENT DATA AND PARTLY DUE TO DIFFERENT ASSUMPTIONS. OUR CURRENT ESTIMATES AND PROJECTIONS ARE LIMITED OFFICIAL USE

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TIONS (SEE REF C) INDICATE TRADE DEFICITS OF ABOUT \$50 MILLION LAST YEAR AND \$230 MILLION THIS YEAR, IN COMPARISON TO BANK FIGURES OF \$450 MILLION AND \$900 MILLION. OUR ESTIMATES DIFFER BECAUSE WE ARE ESTIMATING HIGHER EXPORTS AND LOWER IMPORTS. FOR 1977/78 WE SEE SUGAR EXPORTS OF \$205 MILLION COMPARED TO BANK FIGURES OF \$125 MILLION. ON THE IMPORT SIDE, WE ARE ONLY ESTIMATING GRAIN IMPORTS OF 500,000 TONS (\$65 MILLION AT CURRENT MARKET PRICES) COMPARED TO BANK ESTIMATES OF A MAXIMUM LEVEL OF 2 MILLION TONS (\$400 MILLION) MADE AT A TIME WHEN WHEAT PRICES WERE SUBSTANTIALLY HIGHER. FOR POL, BECAUSE MOST OPEC COUNTRIES HAVE APPARENTLY DECIDED NOT TO INCREASE PRICES THIS SUMMER, WE HAVE PUT THE IMPORT BILL AT \$1,815 MILLION. AS TO IMPORTS OF CAPITAL GOODS WE SEE SOME INCREASE BUT MOSTLY ON THE ORDER OF \$1,350 MILLION, SUBSTANTIALLY LESS THAN THE \$1,640 MILLION PROJECTED BY THE WORLD BANK. PURCHASES FOR KUDREMUKH AND BOMBAY HIGH WILL BE SPREAD OUT OVER A LONGER PERIOD THAN THAT PROJECTED BY THE BANK.

7. WE HAVE PUT GROSS AID DISBURSEMENTS IN 1977/78 AT THE SAME LEVEL AS LAST YEAR. WE ARE PROJECTING REMITTANCES OF \$1.4 BILLION, DOWN FROM \$1.8 BILLION LAST YEAR. WE SHOW THE OVERALL BALANCE FOR 1976/77 AS A SURPLUS \$1,870 MILLION, \$370 MILLION GREATER THAN THE WORLD BANK, AND FOR 1977/78 AT \$1,365 MILLION, \$1,165 MILLION GREATER. THIS DIFFERENCE IS LARGELY DUE TO OUR LOWER TRADE DEFICIT PROJECTION AND THE LARGER FIGURE FOR GROSS AID DISBURSEMENTS.

NEED FOR AID

8. IN GENERAL WE FIND THE WORLD BANK'S DISCUSSION ON INDIA'S NEED FOR INCREASED AID INCOMPLETE. THE PROPER CONTEXT FOR DISCUSSING AID REQUIREMENTS IS, AS THE WORLD BANK POINTS OUT, THE LONG TERM NEED FOR RESOURCES TO LIMITED OFFICIAL USE

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INCREASE INVESTMENT, STIMULATE ECONOMIC GROWTH, AND REDUCE POVERTY. THE WORLD BANK SUGGESTS THAT THE AID DONORS SHOULD PROVIDE COMMODITIES, SUCH AS EDIBLE OILS, AND POTASSIC AND NITROGENOUS FERTILIZERS. THE PURPOSE OF COMMODITY IMPORTS IN THE RECENT PAST, HOWEVER, HAS BEEN PRIMARILY PRICE STABILIZATION. THE RECENT LIBERALIZATION OF IMPORT POLICY UNFORTUNATELY HAS NOT SEEN A SHARP RISE IN THE IMPORT OF CAPITAL GOODS AND SPARE PARTS, AND THUS DISBURSEMENT OF CAPITAL GOODS AID MAY ONLY INCREASE MARGINALLY.

9. IN ADDITION, AS THE EMPHASIS OF EXTERNAL ASSISTANCE SHIFTS INCREASINGLY TO AIDING THE POOREST SECTORS OF THE ECONOMY, AID IS LIKEWISE INCREASINGLY DISBURSED AGAINST LOCAL COST FINANCING. AS A RESULT, THE NEED FOR FOREIGN EXCHANGE DECREASES AND RESERVES CONTINUE TO INCREASE. THE TRANSFER OF AID UNFORTUNATELY HAS NOT BEEN TAKING PLACE THROUGH IMPORTS OF GOODS AND SERVICES. WHERE HIGHER LEVELS OF AID CAN BE USED FOR THIS KIND OF DEVELOPMENT, THEREFORE, IS A FUNDAMENTAL QUESTION THAT IS NOT SUFFICIENTLY ADDRESSED IN THE REPORT.

POPULATION AND POVERTY

10. THE REPORT'S NEW SECTION ON POPULATION AND POVERTY PRESENTS A REALISTIC REVIEW OF INDIA'S FAMILY PLANNING PROGRAMS FROM INCEPTION, AN ORIGINAL AND EXCELLENT ANALYSIS OF POPULATION AND WORKFORCE PROJECTIONS, AND A CONVINCING REVIEW OF THE INCIDENCE AND GROWTH OF RURAL POVERTY ACCORDING TO AVAILABLE DATA. (URBAN POVERTY, WHICH IS GROWING AT LEAST AS RAPIDLY, IS PERHAPS DISMISSED TOO SHORTLY AS A PARTICULAR MANIFESTATION OF RURAL POVERTY.)

11. SINCE THE REPORT WAS WRITTEN, THE GOI HAS MADE TWO IMPORTANT POLICY STATEMENTS IN THIS AREA. A NEW FAMILY WELFARE POLICY STRESSES WHOLLY VOLUNTARY ACCEPTANCE OF LIMITED OFFICIAL USE

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FAMILY PLANNING AND INTEGRATION OF THE PROGRAM WITHIN OVERALL HEALTH AND WELFARE PLANS. (SEE NEW DELHI 6208 AND TOAID A-23.) A TARGET OF FOUR MILLION STERILIZATIONS WAS ADOPTED FOR IFY 1977/78, PLUS ONE MILLION IUD INSERTIONS, AND TWO MILLION ADDITIONAL CONVENTIONAL CONTRACEPTIVE USERS. SECONDLY, A NEW PLAN FOR HEALTH CARE SERVICES IN RURAL AREAS WAS ANNOUNCED, WHICH IS TO GREATLY EXPAND COVERAGE OF INTEGRATED HEALTH, WELFARE, AND FAMILY PLANNING SERVICES THROUGH USE OF SEMI-PROFESSIONAL WORKERS FROM THE VILLAGES (EMBASSY A-80, TOAID A-24, TOAID A-29). THIS PLAN FOLLOWS QUITE CLOSELY THE RECOMMENDATIONS OF THE GROUP ON MEDICAL EDUCATION AND SUPPORT MANPOWER, FAVORABLY CITED ON P. 52 OF THE THE BANK'S REPORT.

12. US CONSORTIUM REPRESENTATIVES MAY WISH TO EXPRESS INTEREST IN THESE PLANS, AND ENQUIRE REGARDING THE INTENDED PACE OF IMPLEMENTATION AND ADEQUACY OF BUDGETARY ALLOCATIONS FOR THEM. ON THE LATTER POINT, THE NEW GOVERNMENT'S BUDGET, TO BE RELEASED LATER THIS MONTH, WILL BE AN IMPORTANT INDICATION. THE 1977/78 FAMILY PLANNING ACCEPTOR TARGETS APPEAR VERY OPTIMISTIC GIVEN PERFORMANCE LEVELS OF THE PAST THREE MONTHS. FOR

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EXAMPLE, STERILIZATIONS HAVE REACHED ONLY 30 PERCENT OF NORMAL PROGRAM OPERATING LEVELS (I.E., LEVELS PRIOR TO THE INTENSIVE DRIVES OF 1976), AND THERE HAS BEEN NO INCREASE EVIDENT IN ADOPTION OF OTHER METHODS. THE FEASIBILITY OF REACHING THE GOI'S LONG RANGE OBJECTIVES IN BIRTH RATE REDUCTION CITED IN THE REPORT MIGHT THUS BE QUESTIONED, AND DETAILS REQUESTED ON HOW THE NEW APPROACH AND MOTIVATIONAL STRATEGY IS TO REGAIN THE PROGRAM'S MOMENTUM.

COMMENT

13. THE BROAD THRUST OF THE WORLD BANK'S RECOMMENDATIONS IS CONTAINED IN THE FINAL STATEMENT (PAGE 114) THAT ...."IT IS HOPED THAT....THE GOVERNMENT OF INDIA WILL BUILD ON THE RECENT POLICY IMPROVEMENTS, AND PROVIDE THE BASIS FOR A PERIOD OF FASTER GROWTH IN THE FUTURE.... CLEARLY A MORE GROWTH-ORIENTED STRATEGY INVOLVES RISKS. BUT INDIA RARELY HAS BEEN IN A BETTER POSITION TO FACE LIMITED OFFICIAL USE

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RISKS...."

14. THE NEW GOVERNMENT OF INDIA HAS BEEN IN OFFICE ONLY TWO MONTHS, AND IT HAS FOUND IT NECESSARY TO DEVOTE MANY OF ITS ENERGIES TO CONSOLIDATING ITS POLITICAL POSITION. IT HAS STATED IT WILL GIVE GREATER PRIORITY TO AGRICULTURE AND SMALL SCALE INDUSTRIES, BUT IT IS TOO EARLY TO STATE DEFINITELY THE POLICIES IT WILL BE ABLE TO ADOPT ON DEVELOPMENT AND THE PACE OF ECONOMIC GROWTH. THE GOVERNMENT'S PRINCIPAL FOCUS SEEMS TO BE ON CONTROLLING INFLATION. AUSTERITY, REDUCTIONS IN GOVERNMENT SPENDING, AND REDUCING THE BUDGET DEFICIT HAVE BEEN PERSISTENT THEMES OF THIS POLITICAL LEADERSHIP. RISING PRICES ARE A HIGHLY SENSITIVE ISSUE IN THE CURRENT POLITICAL ARENA SO THAT IT IS NOT SURPRISING THAT THEY SHOULD BE A PRIME INITIAL TARGET OF THE NEW GOVERNMENT AS IT SHORES UP ITS DOMESTIC POSITION. BUT IT IS BY NO MEANS CERTAIN THAT THE NEW GOVERNMENT INTENDS AND HAS THE WILL, AS IT GETS THE REINS MORE FIRMLY IN HAND, TO MOVE BEYOND AN ATTACK ON INFLATION TO ACCEPT THE POLICY OF

FASTER ECONOMIC GROWTH ADVOCATED BY THE WORLD BANK.

15. THE BUDGET EXPECTED TO BE PRESENTED LATER THIS MONTH WILL PROBABLY NOT BE VERY INNOVATIVE SINCE THERE WILL HAVE BEEN INSUFFICIENT TIME TO DEVELOP ECONOMIC POLICIES. AT THE SAME TIME, THE NEW GOVERNMENT IS STILL A RELATIVELY FRAGILE COALITION WHICH COULD LIMIT THE AMOUNT OF REFORMS ESSENTIAL TO PROGRESS, ESPECIALLY IN AGRICULTURE.

16. NONE OF THESE FACTORS LEAD TO THE CONCLUSION THAT GOVERNMENT POLICIES WOULD "...PROVIDE THE BASIS FOR A PERIOD OF FASTER GROWTH...." THEY WOULD, IN FACT, TEND TO INDICATE THAT INDIA MAY CONTINUE THE CAUTIOUS, CONSERVATIVE DEVELOPMENT STRATEGY THAT INDIAN GOVERNMENTS HAVE PURSUED SINCE INDEPENDENCE. WHILE WE ARE NOT AT THIS POINT QUESTIONING INDIA'S NEED FOR EXTERNAL ASSISTANCE LIMITED OFFICIAL USE

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OR EVEN SUGGESTING AT WHAT LEVEL IT SHOULD BE, WE DO BELIEVE IT IS APPROPRIATE TO ASK SOME HARD QUESTIONS AT THE CONSORTIUM MEETING. WE LIST SOME SUGGESTED ONES BELOW:

A. FOR WHICH PURPOSES AND TO WHAT EXTENT DOES THE GOVERNMENT INTEND TO USE ITS GROWING FOREIGN EXCHANGE RESERVES FOR DEVELOPMENT FINANCING?

B. SINCE THE GOVERNMENT IS NOT NOW EXPEDITIOUSLY UTILIZING ALL THE EXTERNAL ASSISTANCE IT RECEIVES, WILL AID TRANSFERS LEAD TO INCREASED IMPORTS OF GOODS AND SERVICES, AS THE BANK RECOMMENDS?

C. IS THERE A NEED FOR A SUBSTANTIAL INCREASE IN THE LEVEL OF AID TO INDIA?

D. IS INCREASED EMPHASIS ON AGRICULTURE, RURAL DEVELOPMENT AND HEALTH TO BE FINANCED PRIMARILY BY A REALLOCATION WITHIN CURRENT BUDGET LEVELS OR OVERALL BUDGETARY INCREASES? SINCE THESE SECTORS REQUIRE RELATIVELY LITTLE EXTERNAL FINANCIAL INPUTS, WHAT SHOULD BE THE ROLE OF FOREIGN ASSISTANCE IN PROMOTING RURAL DEVELOPMENT?

E. HOW WILL THE GOVERNMENT SUCCESSFULLY IMPLEMENT POLICIES THAT WILL GIVE HIGHER PRIORITY TO AGRICULTURE AND EMPLOYMENT GENERATION? WILL THE GOVERNMENT'S APPARENTLY AUSTERE SPENDING POLICIES RESULT IN MORE FUNDS FOR DEVELOPMENT AND FASTER ECONOMIC GROWTH?

F. WHAT ARE PLANS FOR USING FOOD STOCKS IN EXCESS OF BUFFER REQUIREMENTS FOR DEVELOPMENT PURPOSES?



G. CAN THE GOVERNMENT REACH ITS FAMILY PLANNING  
TARGETS AND REGAIN PROGRAM MOMENTUM UNDER THE NEW FAMILY  
WELFARE POLICY? WHAT IS THE INTENDED PACE OF IMPLEMEN-  
TATION AND BUDGET TO BE ALLOCATED TO THIS ACTIVITY?  
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H. IN LIGHT OF HER IMPROVED ECONOMIC SITUATION, TO  
WHAT EXTENT DOES INDIA PLAN TO USE LOANS FROM BIRD AND  
IFC?  
GOHEEN

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